

Chapter 9

Public Policies and Public Programs With a Regional Impact in Promoting Entrepreneurship: The Case Study of Government Backed Venture Capital Schemes in the UK

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ABSTRACT

This chapter adds to the growing literature from recent years on innovation finance, innovation systems, and regional economic policy. Although the role of business has been seen as critical within the regional innovation system, the role of business financing intermediaries has received considerably less attention despite their recognised role as a central actor of the system. This chapter focuses on an innovation player that seems to have been neglected by scholars to date, namely the venture capital industry. It examines the role of public policies in promoting entrepreneurship through the UK government backed venture capital schemes. It investigates whether and how the public interventions have changed the availability of venture capital at the UK regional level. It also elaborates on the potential implications of the public sectors' domination in venture capital provision in several UK regions.

INTRODUCTION

The study of venture capital (VC) and its relationship with regional development remains relatively underdeveloped in comparison to some of the core economic geography topics such as innovation, technology transfer, the knowledge economy and clusters. Venture capital is defined as “independent, professionally managed, dedicated pools of capital that focus on equity or equity-linked investments in privately held, high growth companies” (Gompers & Lerner, 2001:146). However, the role that venture

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capital plays in underpinning vibrant economies and supporting the entrepreneurial process is in fact well established (Zook 2000; Cooke 2001; Mason & Harrison 2002a, 2003). The impact of VC in innovation is also well documented mainly by empirical studies undertaken in the United States. A study conducted by Kortum and Lerner (2000) suggests that increases in venture capital activity are strongly associated with increases in innovation activity and that by 1998 the provision of venture capital funding to firms accounted for about 14 percent of U.S. innovative activity. Another study, again conducted in the U.S by Puri and Zarutskie (2008), suggests that the amount of employment generated by VC backed firms accounts for nearly 10 percent of employment in the US in the late 1990s and early 2000s, steadily rising from about 5 percent in the 1980s. Illustrating the diversity of factors involved in the “innovation growth engine” of a leading region, namely Silicon Valley, Cooke (2003) highlights that venture capital is crucial as the means by which ideas have been screened and selected given a chance to fly as commercial products or services. Komninos (2004) regards funding organisations amongst the critical components of a regional innovation system and argues that integration takes place between the separate components of the regional innovation process: R&D, innovation finance, technology transfer, new product development, and co-operation production.

To date, most of the work conducted on UK venture capital and its regional impact, has been concerned with mapping the spatial distribution and take up of venture capital investment and drawing out the possible implications for regional development (Mason 1987; Mason & Harrison 2002a, 2003; Sunley et al. 2005, Murray 2007). Particular focus has also been given to the geographical heterogeneity of the finance industry which has highlighted the high concentration of risk capital investments in South East and East England (notably Cambridge), regions with, commonly acknowledged, effective regional innovation systems in place (see SQW ‘The Cambridge Phenomenon’ 1985). It is believed that the concentration of both venture capital and knowledge based firms established in these two regions has provided significant advantages and opportunities for their regional innovation systems to flourish.

A strong regional innovation system can be seen as one with systemic linkages between different sources of knowledge production (universities, research institutions, and other intermediary organisations) and both large and small firms (Cooke 2003). These organisations contribute to the generation and diffusion of knowledge by establishing stable pathways of information with a distinctive group of regional players. Amongst these players, finance organisations have a prominent role and constitute an essential part of the innovation system as finance capital (defined broadly as capital that is invested in companies, new products, shares, stock etc.) is essential for any type of economic development. One particular source of capital, the VC industry, is an integral part of the innovation system as it tends to establish operational frameworks and close working relationships with other players of such system in particular universities, incubators, accelerators, laboratories, research institutes etc. The VC community therefore, shares common ground with both the finance community and the innovation community.

Some of the most developed regional innovation systems (such as Silicon Valley and Cambridge) are widely acknowledged to have a range of networks, stakeholders and institutions that help explain their innovation and economic success (see Porter 1998, Cooke 2001, 2002). These regions typically host world-class universities and research institutions which are actively involved in the creation of spin out firms and the exploitation of intellectual property rights. However, a further key part of the explanation offered for high levels of innovation and new firm creation is that these regions have attracted, or had easy access to, substantial venture capital investment through funds that are either based in the region or in an adjacent geographical area (SQW 1985). Boston and Cambridge (UK) are interesting instances of world-class science attracting critical mass in venture capital (Cooke 2002). It is believed that the extreme

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